



Discovering the importance of a financial plan

When retirees Bill and Carroll Cole decided that they wanted to embark on major home renovations, they gave their financial advisor, David a call to see what they could afford. Since their short-term objectives were clearly changing, David suggested that this might be a good time to revisit their long-term financial plan.

A good financial plan is much more than a simple investment strategy that takes into account your tolerance for investment risk. A financial plan should offer a comprehensive overview of your short- and long-term financial objectives, tax situation, and sources of income – both present and future. Once complete, a financial plan should provide a snapshot of your current financial situation and give you a roadmap that shows you how to achieve your future goals.

As you travel through life's stages and build wealth over time, there are some important advantages to

regularly reviewing your financial plan with your advisor. In the Coles' case, their review enabled them to incorporate a creative investment strategy to assist them in achieving their short-term financial goals and lifestyle priorities, while guaranteeing a secure source of income for life. Let's look at Bill and Carroll's situation a little more closely.

Bill, age 71, retired from a successful career as a telecommunications manager with a pension that helps cover the couple's day-to-day expenses. Bill shares non-registered investments with Carroll, age 68, a former baker, who also has a RRIF investment.

The Coles, who live in Brandon, Manitoba, managed to pay off their mortgage some time ago, but are still experiencing an income shortfall of approximately \$10,000 when they include retirement lifestyle priorities, such as travel and education savings for their grandchildren, in their budget.

Bill and Carroll's two children, Jennifer and Andrew, have grown up and moved away from home. Jennifer,



age 35, lives in Vancouver, and is married with three children. Andrew, age 25, attends the University of Western Ontario where he is working to complete his MBA.

THE FIRST MEETING

David asked Bill and Carroll to make a list of their short-term and long-term objectives and bring it to the meeting he scheduled to discuss their financial plan. The Coles said they wanted to:

- Ensure they would have enough income to last through both of their lives while maintaining their current standard of living
- Spend approximately \$25,000 to renovate their home, including the kitchen, bathroom and deck
- Visit their daughter Jennifer in Vancouver once a year while leaving enough aside for other travel
- Contribute to their grandchildren's future education

With their list of goals and a picture of their overall financial health in hand (see chart), David began helping Bill and Carroll update their financial plan to meet their current and future needs.

THE CHALLENGES

The first requirement was to address the Coles' income shortfall which occurred when lifestyle expenses were worked into their budget. When David tallied up the couple's sources of income – including Old Age Security, their Canada Pension Plan, Bill's pension and



Financial Snapshot

Net Worth

Assets	
Home	\$ 350,000
Vehicle	\$ 30,000
Carroll's RRIF	\$ 200,000
Non-Registered Savings (mainly GICs)	\$ 250,000
Bank Savings Accounts	\$ 10,000
Total Assets	\$ 840,000
Liabilities	
Car Loan	\$ 30,000
Net Worth	\$ 810,000

Cash Flow

Annual Income		(after tax) †
OAS (\$11,070 or \$5,500 each)	\$	8,620
CPP (\$18,720)	\$	14,600
Bill's Pension (\$21,050)	\$	16,000
Carroll's RRIF Income (\$9,100)	\$	7,280
TOTAL	\$	46,500
Annual Expenses		
Basic Living Expenses (groceries, clothing, property taxes, utilities, house & car insurance, etc.)	\$	21,100
Medical & Drug Costs	\$	4,300
Dining Out & Entertainment	\$	2,800
Car Loan	\$	6,200
TOTAL	\$	34,400
Net Balance	\$	12,100
(Annual Income - Annual Expenses)		
Lifestyle Expenses		
Travel (flights, insurance & accommodations)	\$	16,000
Education Savings for Grandchildren	\$	6,000
TOTAL EXPENSES	\$	56,400
(Annual + Lifestyle Expenses)		

Cash Flow Shortfall
(including Lifestyle Expenses after tax) - (\$ 9,900)

Additional Potential Expenses in the Future

Major Home Repairs
Nursing Care Expenses

† Effective Tax Rate

Bill 24%
Carroll 20%



Carroll's RRIF income – it was clear that their current income would not cover their annual expenses and their lifestyle expenses which they wanted to include in their plan.

David started to look at a number of income options. He quickly realized, however, that traditional interest bearing securities such as Guaranteed Investment Contracts (GICs) would not support Bill and Carroll's income needs for the rest of their lives. In addition, the extra income generated would likely increase their marginal tax bracket from the current 35 per cent, which could threaten their eligibility for government benefits such as Old Age Security, Age Credits and Medical Expense Credits. Withdrawing additional income from Carroll's RRIF was also a problem since these withdrawals would be taxed at the couple's highest applicable tax rate.

Another concern was investing in the volatile financial markets. Bill and Carroll wanted to build the value of their estate for their children, and while they knew that equity-based mutual funds could be effective tools for growing wealth, they were worried about market volatility. Despite David's gentle reminder that the stock markets have superior return potential, Bill and Carroll were not comfortable with this investment option alone.

David told them he would give some more thought to the Coles' income needs and call them once he had prepared his recommendations. Before they left, though, one other subject came up. Carroll had experienced some difficulties managing her mother's estate, so she wanted to make sure her own estate plan was in order. She asked David to consider the best

means of transferring assets to the Cole children, Jennifer and Andrew. David explained that some investments could actually bypass the inconveniences of probate and estate administration fees, saving valuable time and money and promised to look into these options for them.

When David called the following week, he was pleased to report he had some good news: he believed that he had been able to address their concerns in one comprehensive financial plan. He scheduled a second meeting with Bill and Carroll to review his proposal.

DAVID'S RECOMMENDATIONS

The first suggestion that David made was that the Coles use \$225,000 of their non-registered assets to invest in a power of three strategy. A power of three strategy is unique, since it combines the characteristics of three different types of investments – annuities, GICs and segregated funds with a 10 year guarantee – to create a comprehensive solution for short-term and long-term financial goals. Of the Coles' \$225,000 investment,

- 66 per cent would be used to purchase a prescribed joint annuity to give the couple guaranteed income for life. The income from an annuity is more tax-efficient than income from GICs and wouldn't have much affect on the Coles' eligibility for income-tested government benefits
- 17 per cent would go towards a GIC to provide guaranteed growth and security – no matter what the financial markets do. In addition, because this GIC is cashable at any time*, it will give Bill and Carroll easy

access to their money if they need it. Since this GIC is purchased through an insurance company, the Coles would also receive the additional estate planning benefits they require

- 17 per cent would be invested in a segregated fund to grow their wealth over time. A segregated fund is similar to a mutual fund, but has a number of benefits that help limit risk and important estate planning advantages

David calculated that this strategy could produce an additional \$9,900 after tax annually to cover the couple's income shortfall with a significant portion left over that would grow** over time and would be available to them if needed.

Bill and Carroll were pleased with David's recommendations. It was a great relief to know that virtually all of their long-term financial concerns were being addressed in their financial plan, and that their new investment strategy provided them with the money they wanted for travel and saving for their grandchildren's education, too. Best of all, they were glad they did not have to expose a large percentage of their savings to volatile financial markets. However, there were still some details that needed to be addressed.

PROTECTION BENEFITS

Because the investments within a power of three strategy are offered by an insurance company, this strategy offers several advantages over investments sold by other financial services organizations, such as:

- Annuity payments made by an insurance company can be guaranteed to last for life. Other financial services organizations can only offer annuity income for a fixed period of time

- GIC and segregated fund investments offered by an insurance company permit investors to name beneficiaries, which allows their assets to bypass the expense of probate and estate administration fees

- Investments sold by an insurance company can be guaranteed. For example, it's possible to guarantee that a minimum amount be paid out of the annuity to beneficiaries in the event of the annuitant's early death, and segregated fund investments can guarantee to return 75 per cent as long as withdrawals are not taken

FINE-TUNING THE PLAN

Bill and Carroll wanted to resolve exactly how they should pay for their home renovations. With some cost estimates in hand, Bill asked David to determine the best way to fund the project. David suggested they use the remaining \$25,000 of their non-registered assets so they could avoid either taking out a loan – which would incur interest expenses – or gradually saving money from their RRIF income – which would only delay their plans. That made sense to them.

Carroll had one last investment question she wanted David to help address: What was the best investment vehicle for the \$6,000 she had budgeted annually to invest in her grandchildren's post-secondary education? What would happen if one of Jennifer's children did not

* Subject to potential charges.

** Guaranteed 2.5% annual compound rate of return (growth portion).





want to attend? Also of concern was the best means to make her annual contribution – as a lump-sum payment once a year or monthly?

David recommended that the Coles open a family plan RESP, and name all three grandchildren as beneficiaries. The family plan RESP would provide them with the flexibility to name additional beneficiaries who were related by blood, if their daughter Jennifer were to have any more children or if their son Andrew was to start a family. This type of RESP would also allow them to transfer assets to another grandchild, if one child decided not to attend a qualifying post-secondary institution.

RESPs, of course, have other important benefits as well. Carroll could choose to withdraw all of the contributions she makes to an RESP without a tax penalty. In addition, all contributions can be invested in growth-oriented securities such as mutual funds, and investment returns can compound tax free for up to 25 years, or until withdrawn (withdrawals may be subject to tax). Finally, up to applicable limits, contributions are eligible for the Canadian Education Savings Grant (CESG), a government grant that matches contributions by up to 20 per cent per year, to a maximum of \$400 per beneficiary, per annum.

Since the Coles had already worked the \$6,000 for the RESP into their budget, David told them it was up to them if they wanted to make a lump sum yearly contribution or monthly payments. For easier budgeting, Bill and Carroll decided that monthly payments into a family plan RESP would be the best way for them to invest.

CONCLUSION

A few short weeks after they first started seriously considering renovating their house, Bill and Carroll had a clear idea of what they could afford and where the money to pay for their new kitchen, bathroom and deck should come from. Thanks to their financial advisor, they also got an updated financial plan that enables them to meet their short-term and long-term objectives, incorporates their lifestyle priorities, and answers their estate planning concerns. Through the creative use of investments including annuities, GICs and segregated funds, Bill and Carroll can start picking out fixtures and cabinets with confidence, as they look forward to a financially secure retirement.

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